

IT 00-23

Tax Type: Income Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

JOHN DOE et al.
Responsible Officers for
ABC Transportation Co.,
Taxpayer

No. 98-IT-0000
IBT No. 0000-0000
NODs No. 0000 & 0000

Charles E. McClellan
Administrative Law Judge

RECOMMENDATION FOR DECISION

Mark Dykman for the Department of Revenue; Francis J. Emmons and Kenneth H. Denberg of Schwartz & Freeman for JOE BLOW; JOHN DOE appeared *pro se*.

Synopsis:

This matter involves timely filed protests to identical Notices of Deficiency issued by the Department on April 12, 1997, to JOHN DOE (“DOE”) and JOE BLOW “(BLOW”) for the penalties provided in § 1002(d) of the Illinois Income Tax Act and § 3-7(a) of the Uniform Penalty and Interest Act.¹ The penalties are assessed against DOE and BLOW as responsible parties for failure to collect and pay over to the Department withholding taxes of employees of ABC Transportation Company for the third and fourth quarters of 1993 and all four quarters of 1994 as required by IITA § 701.

¹ Unless otherwise noted, statutory references to the Illinois Income Tax Act, 35 ILCS 5/101, *et seq.*, will be noted as “IITA §”. References to the Uniform Penalty and Interest Act, 35 ILCS 735/3—1 through 11, and will be noted as the “UPIA §”.

A pre-trial order was entered on October 5, 1999, in which the issues were set forth as follows:

- 1. Whether taxpayers may challenge the underlying assessments that are set forth in the Notices of Deficiency. (Taxpayer waived this issue at the hearing. Tr. p. 13.)**
- 2. What categories of individuals are covered as “responsible persons” under the IITA and the UPIA.**
- 3. Whether Messrs. DOE and BLOW were “responsible officers/employees” for ABC for the periods referred to in the Notices of Deficiency.**
- 4. Whether the actions of Messrs. DOE and BLOW in failing to pay the assessed taxes were “willful” as that term is defined in the statutes.**
- 5. What documentary proof, if any, is required for taxpayers to overcome the Department’s *prima facie* case in this matter.**

An evidentiary hearing was held in this matter on December 22, 1999. Both parties filed post-hearing briefs. I recommend that the Department’s Notices of Deficiency be made final.

Finding of Facts:

- 1. ABC Transportation Company (“ABC”) was incorporated in Illinois on July 17, 1991. BLOW Ex. 6.²**
- 2. ABC was engaged in the business of transporting children to and from school. Tr. p. 92.**
- 3. BLOW is a commodities broker who has maintained an office at the Chicago Board of Trade for the last 25 or 30 years. Tr. pp. 79, 91.**
- 4. During the years at issue BLOW was the sole shareholder and director, Chairman, or Chairman of the Board of ABC. Tr. p. 92; Dept. Group Ex. No. 4, 5, 9, 10; BLOW Ex. 6.**

² Exhibits offered into evidence by BLOW will be identified as “BLOW Ex. “n” (Where “n” is the exhibit number) to be consistent with the method used by BLOW’s counsel to identify them at the hearing.

5. BLOW first hired DOE as general manager for XYZ, Ltd. in 1990. Tr. p. 57; Dept. Ex. No. 6.
6. BLOW purchased XYZ, Ltd. in December 1991, changed its name to ABC and made DOE president. Tr. p. 58.
7. DOE was president of ABC from 1992 through early 1995. Tr. p. 24, Dept. Ex. 5; BLOW Ex. 6.
8. During the years at issue MR. SMITH was the Controller of ABC. Tr. p. 29.
9. During the years at issue MR. JONES was Secretary/Treasurer and chief operating officer of ABC. Tr. p. 29; Dept. Ex. 5, BLOW Ex. 6.
10. During 1993 and 1994, ABC experienced cash flow problems. Tr. p. 41.
11. On or about January 1, 1992, DOE signed the NUC-1 Illinois Business Registration form as the person responsible for payment of taxes. Dept. Group Ex. No. 4.
12. DOE also signed IL-941 Employer's Quarterly Illinois Withholding Tax Returns for the quarters ended June 30, 1993, September 30, 1993, and December 31, 1993. Tr. pp. 29, 30; BLOW Group Ex. No. 1.
13. These IL-941 forms were filed without checks being attached to pay the liabilities reflected thereon. Tr. p. 33.
14. At the time withholding taxes were due, other creditors were being paid and DOE was receiving his salary. Tr. pp. 34, 90.
15. In a letter dated November 22, 1994, addressed to DOE, an assistant vice president of Bank One informed DOE that ABC was 58 days past due on a \$354,326 loan, and asked for financial information previously requested, but not provided, about the company and BLOW. Tr. p. 60; Dept. Ex. No. 7.
16. The Department of Revenue sent ABC a Notice of Intent to Hold Corporate Renewal dated April 26, 1994, which informed ABC that its license to do business would not be renewed unless withholding taxes for the second, third and fourth quarters of 1993 were paid. Tr. p. 60; Dept. Group. Ex. No. 8.

17. DOE responded to the Department by letter and forwarded checks to be credited against the withholding tax liability. *Id.*
18. BLOW personally guaranteed loans to ABC from Bank One in 1992 and 1993. Dept. Group Ex. No. 9.

Conclusions of Law:

The issue in this case is whether DOE and BLOW are responsible persons who willfully failed to file and pay withholding taxes for ABC as required by statute.

IITA § 1002(d) imposes the penalty at issue, in relevant part, as follows:

Any person required to collect, truthfully account for, and pay over the tax imposed by this Act who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable for the penalty imposed by Section 3-7 of the Uniform Penalty and Interest Act.
35 ILCS 5/1002(d).

Section 3-7(a) of the Uniform Penalty and Interest Act (“UPIA”), in relevant part, provides as follows:

Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who willfully fails to file the return or make the payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon. The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be *prima facie* correct and shall be *prima facie* evidence of a penalty due under this Section. Proof of that determination by the Department shall be made at any hearing before it or in any legal proceedings by reproduced copy or computer printout of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. . . .
35 ILCS 735/3-7(a)

These sections, taken together, prescribe two tests to determine if an individual is personally liable for unpaid withholding tax. First, under both provisions, the person must be responsible for accounting for and paying the tax due. Second, the individual must willfully fail to file or pay the tax shown to be due on the payroll tax returns.

Once the Department introduced into evidence the NODs under the Director's certificate (Dept. Ex. No. 1), its *prima facie* case was made on the questions of responsibility and willfulness. Branson v. Dept. of Revenue, 168 Ill.2d 247, 261-262 (1995). The burden then shifted to DOE and BLOW to overcome the Department's case. *Id.* To rebut the Department's *prima facie*, DOE and BLOW had to come forward with sufficient evidence to disprove the Department's case. Branson, 168 Ill.2d at 262. The record shows that they failed to do that. Because BLOW and DOE had different relationships with ABC, I will address each one separately starting with BLOW.

BLOW's Liability

BLOW was the sole shareholder, sole director and chairman of ABC. Tr. p. 92; Dept. Group Ex. No. 4, 5, 9, 10; BLOW Ex. 6. BLOW guaranteed loans to ABC from Bank One in 1992 and 1993 in excess of \$1,000,000. Dept. Group Ex. No. 9. His personal accountant testified that as the result of the financial failure of ABC, BLOW lost more than \$1,000,000. Tr. pp. 78, 79.

The first issue to be decided is whether BLOW was a responsible person within the meaning of the statutes. BLOW argues that UPIA § 3-7 limits liability to officers or employees of the taxpayer. He maintains that since he was neither an "officer" nor an "employee" of ABC during the relevant time period, he was not one of the categories of persons potentially subject to vicarious liabilities for its tax obligations under the language UPIA § 3-7.

The language in IITA § 1002(d), quoted above, is identical, in relevant part, to the language in the first sentence of Section 6672 of the Internal Revenue Code, 26 U.S.C. § 6672, that imposes a penalty for failure to collect and pay federal withholding tax. In applying the penalty tax under the Illinois statutes, the Illinois courts look to federal cases involving § 6672 of the Internal Revenue Code, which contains language similar to the

Illinois statute. Branson, 168 Ill.2d at 261, Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill.2d 568, 369 N.E.2d 1279.

The federal courts have held that the liability attaches to those who have the power and responsibility within the corporation for seeing that tax owed is paid and that responsibility is generally found in high corporate officials charged with general control over corporate business. Monday v. U.S., 421 F.2d 1210, (7th Cir. 1970), cert. den. 400 U.S. 821. Responsibility is not a matter of knowledge, but rather a matter of status and authority. Mazo v. U.S., 591 F.2d 1151 (5th Cir. 1979). As the sole shareholder and sole director of ABC, BLOW had the status, the power and the authority to control the business. Therefore, he had the ultimate responsibility for making sure that the withholding taxes were paid and was a responsible person under the statute.

BLOW's construction of the statute is incorrect. As noted above, the case law and IITA § 1002(d) impose the penalty on "**Any person** required to collect, truthfully account for, and pay over the tax imposed by this Act . . ." (Emphasis added) The primary rule of statutory construction is to ascertain and give effect to the intention of the legislature and that inquiry must begin with the language of the statute. Van's Material Co. v. Dept. of Revenue, 131 Ill. 2d 196, 202 (1989). The language of a statute generally provides the best evidence of the legislature's intent. Board of Education of Rockford School District No. 205 v. Illinois Educational Labor Relations Board, 165 Ill. 2d 80, 87 (1995). Statutes are to be construed so that no term is rendered superfluous or meaningless." Niven v. Siqueira, 109 Ill.2d 357, 365 (1985); TTX Company v. Whitley, 295 Ill.App.3d 548, 554 (1st Dist. 1998).

Construing IITA § 1002(d) and UPIA § 3-7 under these principles makes it clear that the legislature intended to impose the penalty for failure to collect and pay Illinois withholding tax on the same classification of people as are liable for failure to collect and pay federal withholding tax. Accordingly, the fact that BLOW was not an officer or an employee of ABC did not relieve him of potential liability for failure to collect and pay Illinois withholding tax. BLOW being the sole shareholder and sole director had the ultimate power and authority to make sure the withholding tax liability was given priority over other creditors. BLOW's construction of IITA § 1002(d) and UPIA § 3-7 would render the language in IITA § 1002(d) meaningless. Therefore, his construction of the statutes is incorrect.

BLOW next argues that he was not a person who had control, supervision or responsibility for ensuring that the payroll tax returns were filed and the tax paid. As BLOW points out, this is a “facts and circumstances” issue, citing Branson, *supra*. BLOW relies on Fiataruolo v. U.S., 8 F.2d 930 (2nd Cir. 1993). In that case, the court listed a number of factors to consider in determining whether an individual is a responsible person under the statute. These factors are whether the person: (1) is an officer or member of the board of directors, (2) owns shares or possesses an entrepreneurial stake in the company, (3) is active in management, (4) has the ability to hire and fire employees, (5) makes decisions regarding which, when and in what order outstanding debts or taxes will be paid, (6) exercises control over daily accounts and disbursement records, and (7) has check signing authority. Fiataruolo v. U.S., 8 F.2d at 939.

The court went on to state: “It should be noted that a person need not hold any particular position in a business and need not actually exercise authority to be held a

responsible party for the payment of the withheld taxes. The question of control over the employer's finances must be answered in light of the totality of the circumstances; no one factor is determinative." *Id.* In this case, BLOW was not merely a member of the board of directors, he was the board of directors. He was the sole shareholder and that gave him an entrepreneurial interest in ABC. As the sole shareholder and sole director he had the ability to hire and fire employees and did so when he hired DOE as general manager and then president of ABC. As sole shareholder he also had the ability to decide what creditors would be paid and the order in which they would be paid.

BLOW argues that he had no role in the day to day affairs of the business, no involvement in daily accounts and disbursement records, no check signing authority, and no authority under the by-laws to hire and fire rank and file employees. BLOW testified that he did not know that ABC was not making payroll deposits. Tr. p. 93, 94. He testified that he personally paid payroll taxes for 1995, but did not know why he did not pay the 1993 and 1994 liabilities. Tr. p. 94. He testified that he did not know when he found out that the payroll taxes for 1993 and 1994 were unpaid. *Id.* Although eleven months prior to the hearing on this matter, on January 19, 1999, BLOW signed an affidavit in which he admitted learning about the unpaid taxes "on or about February 1995" (Dept. Ex. No. 10) he testified that he did not remember doing it. Tr. p. 95.

DOE, the president of ABC, testified that he had discussions regarding some sort of takeover of ABC during December of 1994 with SENIOR ACCOUNTANT ("ACCOUNTANT") who had been BLOW's personal certified public accountant for about 25 years. Tr. pp. 43, 44, 75. He had similar discussions with Kenneth Denberg, a partner of taxpayer's counsel in this matter, during January of 1995. Tr. p. 44. MR. DOE testified

that ABC changed bank accounts about every six months, on the advice of ACCOUNTANT, to avoid having the funds of ABC seized by the Internal Revenue Service. Tr. pp. 53, 54, 71. DOE testified that on the advice of ACCOUNTANT, the form IL-941 reporting withholding tax was filed with the word “none” shown for tax due when ABC did not have sufficient funds to pay the tax. Tr. pp. 33, 68, 71, 72. DOE testified that ACCOUNTANT was BLOW’s personal accountant and adviser and that he was advised to consult ACCOUNTANT on “everything”. Tr. p. 72.

BLOW’s testimony is not persuasive of his assertion that he was not involved in the activities of ABC to some extent during the periods that the taxes were unpaid. ACCOUNTANT testified that BLOW’s loss of funds invested in ABC exceeded one million dollars. Tr. pp. 78, 79. DOE’s testimony regarding ACCOUNTANT’s advice to change bank accounts every six months or so, indicates that ACCOUNTANT was aware of ABC’s unpaid withholding taxes. DOE’s testimony that he was advised to consult ACCOUNTANT on “everything” indicates that ACCOUNTANT was well aware of the fact the ABC was generating insufficient funds to pay all of its creditors on time. Furthermore, the very fact that he dealt with ACCOUNTANT was because BLOW **told** him to, thereby indicating that BLOW was aware of the situation regarding unpaid withholding taxes.

As BLOW’s accountant and adviser for 25 years, it is inconceivable that ACCOUNTANT would not have advised BLOW of ABC’s financial situation and the risks of not paying withholding taxes. The evidence in the record, particularly DOE’s testimony indicating that ACCOUNTANT knew that withholding taxes were not being paid, that ACCOUNTANT was consulted about ABC’s situation during the periods at

issue, that ACCOUNTANT advised him to change banks to keep ABC's funds from being attached by the Internal Revenue Service, and ACCOUNTANT's position as BLOW's personal accountant and advisor for 25 years lead to the conclusion that BLOW was aware of ABC's precarious financial situation during 1993 and 1994, including the fact that withholding taxes were not being paid.

However, even if BLOW was not involved in the day to day activities of ABC, that would not insulate him from liability. A "responsible person" for purposes of the penalty statute is not limited to the person assigned the responsibility for paying the tax and filing the returns. Wright v. U.S., 809 F.2d 425, 427 (7th Cir. 1987). Liability cannot be avoided by compartmentalizing responsibilities within a business. *Id.* A "responsible person" is liable if he should have known that there was a grave risk that the taxes were not being paid and he was in a position to find out for certain very easily. *Id.* "The willfulness requirement of § 6672 is satisfied if the responsible person acts with a reckless disregard of a known risk that the trust funds may not be remitted to the Government such as by failing to correct mismanagement after being notified that the withholding taxes have not been duly remitted. [Citation omitted.] A responsible person's use of funds, or his knowledge of the use of funds for payments to other creditors after he is aware of the failure to pay the withholding tax, is willful conduct within the scope of § 6672." Garsky, v. U.S., 600 F.2d 86, 91 (7th Cir. 1979).

BLOW is experienced financially. As sole shareholder and director of ABC, BLOW was in a position to know of its financial difficulties including its tax arrearages. The testimony regarding the monitoring of ABC's situation by ACCOUNTANT indicates that BLOW was in a position to know, and most likely did know, of the delinquent

withholding taxes. BLOW introduced no documentary evidence to support his testimony. The totality of the record establishes that BLOW's activities satisfied the willfulness requirement of IITA § 1002(d) and UPIA § 3-7(a). and that he has failed to overcome the Department's *prima facie* case establishing that he was a responsible person who willfully failed to pay the withholding taxes underlying this penalty assessment.

DOE's Liability

DOE was the president of ABC from 1992 through early 1995. DOE signed the NUC-1 Illinois Business Registration form as the person responsible for payment of taxes. He signed the forms IL-941 Employer's Quarterly Illinois Withholding Tax Returns for the quarters ended June 30, 1993, September 30, 1993, and December 31, 1993. He received a letter dated November 22, 1994 from Bank One regarding ABC's past due loan. He received the Notice of Intent to Hold Corporate Renewal dated April 26, 1994 from the Department of Revenue. He knew that the company was in poor financial shape. He knew that these tax returns were being filed with no payments attached. Tr. 33. During the time period that the taxes at issue were not being paid other creditors and employees, including DOE, were being paid. Tr. p. 34. Under the statutory provisions and case law cited above, DOE, as the president of ABC, was a responsible person who willfully failed to pay the withholding tax of ABC underlying the penalty assessments at issue.

For the reasons set forth above, I find that DOE has failed to overcome the Department's *prima facie* case.

Therefore, I recommend that the Notices of Deficiency issued by the Department on April 12, 1997 to JOHN DOE (“DOE”) and JOE BLOW “(BLOW”) be made final.

ENTER: October 2, 2000

Administrative Law Judge